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November 20, 2013

Sent via Email

John Stevenson
Secretary to the Commission
Ontario Securities Commission
20 Queen Street West
Box 55, Suite 1900
Toronto, ON M5H 3S8

Dear Mr. Stevenson:

**Re: Notice of Requests for a Stay and Hearing and Review of the Decision
of the Director dated November 18, 2013 in the Matter of Sterling
Grace & Co. ("Sterling Grace") and Graziana Casale ("Casale")**

We act for Sterling Grace and Casale.

On or about July 3, 2013, following a compliance review of Sterling Grace conducted pursuant to section 20 of the *Securities Act*, R.S.O. 1990, Ch. S. 5 (the "Act"), Staff of the Ontario Securities Commission (the "Commission") recommended to the Director that, among other things, the registration of each of Sterling Grace and Casale be suspended. Sterling Grace and Casale each exercised their right to an opportunity to be heard (the "OTBH") pursuant to section 31 of Act. The OTBH was conducted, in person, on October 28, 2013.

On November 18, 2013, the Director, Marianne Bridge, issued her decision in which she accepted Staff's recommendations in their entirety (hereinafter, the "Director's Decision"). The Director's Decision was that:

- (a) the registration of Sterling Grace be suspended permanently;
- (b) the registration of Casale as ultimate designated person (UDP) and chief compliance officer (CCO) be suspended permanently;

- (c) the registration of Casale as a dealing representative be suspended, and that she not be permitted to apply for reinstatement for a period of two years;
- (d) Casale successfully complete the *Conduct and Practices Handbook Course* before applying for reinstatement of registration;
- (e) Casale be subject to one year of strict supervision in the event her registration is reinstated; and,
- (f) Casale shall not be a permitted individual of a registered firm for a period of five years.

A copy of the Director's Decision is attached as Schedule "A". In summary, the Director's Decision was based on findings that Sterling Grace and Casale lack the requisite integrity to remain registrants and that they have, in certain respects, failed to comply with Ontario securities laws.

As Sterling Grace and Casale are directly affected by the Director's Decision, please accept this letter as a formal request for:

1. A hearing and review of the Director's Decision pursuant to subsection 8(2) of the Act; and,
2. A stay of the Director's Decision pending the disposition of the hearing and review pursuant to subsection 8(4) of the Act.

The grounds for the request are:

- (a) The Director's Decision lacks adequate reasons to explain the basis for the serious findings allegedly warranting suspensions that, in effect, put the registrants permanently out of business;
- (b) The Director erred in conflating issues of proficiency with issues of integrity when determining Casale's and Sterling Grace's suitability for registration;
- (c) The Director erred in finding, on the record before her, that Casale (and Sterling Grace) lacks the requisite integrity for a registrant;
- (d) The Director erred in failing to give due consideration and weight to the evidence submitted by Casale for the OTBH;
- (e) The Director erred in failing to apply relevant prior decisions of a Director and/or the Commission regarding the applicable principles of proficiency, integrity and sanction;
- (f) The Director failed to give due consideration and weight to the level of cooperation demonstrated by Casale and Sterling Grace during the

unannounced Compliance Review which commenced in December of 2012 and concluded in July of 2013;

- (g) The Director failed to give due consideration and weight to the evidence submitted by the registrants regarding the changes made to their policies, practices and procedures since the inception of Staff's unannounced compliance review in December of 2012, in addition to other relevant mitigating factors;
- (h) The Director erred in concluding that it would be inappropriate to allow Casale to remain registered as a dealing representative with terms and conditions on her registration, including strict supervision;
- (i) The Director failed to give due consideration and weight to Casale's stated willingness to step down as CCO and UDP for Sterling Grace and to engage regulatory compliance consultants as appropriate;
- (j) Staff did not seek the imposition of terms and conditions on the registration of either Sterling Grace or Casale in the more than eleven (11) months between the commencement of the unannounced Compliance Review and the date of the Director's Decision;
- (k) Even if Sterling Grace and Casale were successful in whole or in part on the hearing and review, given the severity of the Director's Decision, the harm that the registrants would suffer if a stay is not granted would be irreparable;
- (l) In the circumstances, it is in the public interest to grant a stay of the Director's Decision pending the disposition of the hearing and review; and
- (m) Such further and other grounds as counsel may advise and the Commission may permit.

Given that the Director's Decision is of immediate effect, we request that our clients' request for a stay be heard by the Commission on an urgent basis.

Should you have any questions, please do not hesitate to contact me.

Yours truly,



Melissa J. MacKewn

Enc.

c: Mark Skuce, Ontario Securities Commission
Marianne Bridge, Ontario Securities Commission



Ontario
Securities
Commission

Commission des
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de l'Ontario

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**In the Matter of Staff's Recommendations
to Suspend the Registrations of
Sterling Grace & Co. Ltd. and Graziana Casale**

**Opportunity to be Heard by the Director
Under Section 31 of the Securities Act**

Decision

1. For the reasons outlined below, my decision is that:
 - a. the registration of Sterling Grace & Co. Ltd. (Sterling Grace) is suspended permanently,
 - b. the registration of Graziana Casale (Casale) as ultimate designated person (UDP) and chief compliance officer (CCO) is suspended permanently,
 - c. the registration of Casale as a dealing representative be suspended, and that she not be permitted to apply for reinstatement for a period of two years,
 - d. Casale successfully complete the *Conduct and Practices Handbook Course* before applying for reinstatement of registration,
 - e. Casale be subject to one year of strict supervision in the event her registration is reinstated, and
 - f. Casale shall not be a permitted individual of a registered firm for a period of five years.

Overview

2. By letter dated July 3, 2013, staff (Staff) of the Ontario Securities Commission (the Commission or the OSC) advised Sterling Grace and Casale (the Registrants) that Staff had recommended to the Director, among other things, that the registrations of the Registrants be permanently suspended.
3. The basis of this recommendation is due to the number and severity of significant deficiencies identified during the compliance review of Sterling Grace (Compliance Review) conducted under section 20 of the *Securities Act* (Ontario) (Act), which covered the period from December 2011 to November 2012. Staff has fundamental concerns with respect to the integrity and proficiency of the Registrants.
4. There were seven issues discussed during the opportunity to be heard (OTBH) which occurred on October 28, 2013. Although Staff characterised the first four issues as integrity issues and the last three issues as proficiency issues, many of the issues were both integrity and proficiency issues. Staff also alleged that there was an overall lack of a compliance system at Sterling Grace as a result of these issues. The seven issues, each of which will be discussed separately below, were:
 - a. Conflicts of interest,
 - b. Unreported capital deficiency,
 - c. Misrepresentations to Staff,
 - d. Trading without registration,
 - e. Improper reliance on prospectus exemptions,
 - f. Failure to discharge the know your product (KYP) obligation, and
 - g. Failure to discharge the know your client (KYC) and suitability obligations.
5. All of the issues were contested by the Registrants. As well, I was advised by the Registrants that, should I decide to suspend their registrations, they would seek a stay of this decision.

Background

6. Sterling Grace has been registered as an exempt market dealer (EMD) in Ontario since December, 2006 and in Alberta and British Columbia since February 2012.
7. Casale is registered as UDP, CCO, and a dealing representative with, and is a permitted individual of, Sterling Grace.

Issues discussed during the OTBH

Conflicts of interest

8. Staff alleges that there were three transactions which resulted in conflicts of interest.
9. The first transaction was a \$25,000 personal loan in the spring of 2011 from a company controlled by ES, the principal of Redstone Investment Corporation (Redstone) (an issuer whose securities are distributed by Sterling Grace), to Casale for personal expenses of Casale and operating expenses of Sterling Grace. The loan was evidenced by a promissory note which set out interest and repayment terms.
10. The second transaction occurred in the fall of 2011, when Staff notified Casale that (i) Sterling Grace was capital deficient as at December 31, 2010, and (ii) a recommendation had been made to suspend Sterling Grace because it was capital deficient, had failed to notify the OSC of the capital deficiency, and because the capital deficiency was for a period longer than two days. The capital deficiency was over \$70,000. To rectify the capital deficiency, Casale received an interest free loan of \$73,000 from Redstone. The loan had no fixed terms of repayment and was not evidenced by written agreement.
11. In respect of these first two transactions, despite Sterling Grace receiving approximately \$195,000 in commissions in 2012 from the sale of Redstone securities, neither Sterling Grace nor Casale believed they were in a conflict position with Redstone. As an aside, the commissions earned from the sale of Redstone securities are approximately three times the total amount of commissions earned by Sterling Grace for the sales of all other securities by Sterling Grace.
12. The third transaction was the sale by Sterling Grace of securities of Genwealth Venture LP (Genwealth), a venture capital fund managed by "ML" (who was, at the time of the sales, a registered dealing representative with Sterling Grace). Sterling Grace received approximately \$13,000 in commissions in 2012 from the sale of Genwealth securities. Again, neither Sterling Grace nor Casale believed they were in a conflict position with Genwealth.

Unreported capital deficiency

13. Following the suspension recommendation referred to in paragraph 10 above and Sterling Grace's rectification of its capital deficiency by the injection of \$73,000 into the firm, Sterling Grace was placed on terms and conditions requiring the firm to provide Staff with unaudited financial statements and capital calculations for the months of October 2011 to March 2012, inclusive. The filings provided to Staff indicated that Sterling Grace did not have a capital deficiency for any of these months and the terms and conditions were removed from Sterling Grace's registration in May 2012.
14. However, when the December 31, 2011 audited financial statements of Sterling Grace were filed in late March 2012, a capital deficiency of approximately \$7,000 was identified (despite no capital deficiency being identified as part of the terms and conditions filings). Revised audited financial statements of Sterling Grace in the correct format were filed in late July 2012. The revised audited financial statements also identified a capital deficiency of approximately \$7,000.
15. In late July 2012, Sterling Grace was advised by Staff that it was capital deficient. By subsequent email, Casale indicated that the December 2011 capital deficiency was as a result of expense accruals and referred to the January, February and March 2012 terms and conditions filings as evidence that the firm had sufficient capital during these months. As well, Staff requested (and received) June 2012 financial statements and capital calculations which showed excess working capital of approximately \$9,000. Because the firm demonstrated that it had met its working capital requirements in January, February, March and June 2012, Staff refrained from recommending further terms and conditions on the registration of Sterling Grace.
16. During the Compliance Review, Staff identified that Sterling Grace was capital deficient in April and May 2012. These capital deficiencies were not reported to Staff. The amounts of the capital deficiencies were approximately \$13,000 and \$20,000. Although Casale acknowledged that she was aware of the capital deficiencies at the time they arose, she did not notify Staff even though she was aware of the obligation to do so. She also did not inform Staff on a timely basis of the December 2010 capital deficiency.

Misrepresentations to Staff

17. In the spring of 2012, Staff was reviewing a registration application for EMD registration submitted by “CH”. The principals of CH were “HT” and “RL”, who were also principals of Ginkgo Mortgage Investment Corporation (Ginkgo), an issuer whose securities were previously sold by Sterling Grace.
18. Staff was provided a letter from Ginkgo’s legal counsel, addressed to a consultant of CH, which stated that Ginkgo had issued securities to 19 close personal friends or business associates pursuant to the private issuer exemption, and that the subscriptions were effected through Sterling Grace. Sterling Grace filed a Form 45-106F1 *Report of Exempt Distribution* in early March 2012.
19. Staff was subsequently advised by Ginkgo’s legal counsel that (i) the 19 trades were a one-time trade and were not required to be made through an EMD, (ii) Ginkgo communicated with Sterling Grace in order to effect the distributions and file the F1, and (iii) the F1 was not required to be filed. Staff then asked for confirmation that Ginkgo had made no further distributions of its securities, and a letter from Sterling Grace confirming its role in the issuance of Ginkgo securities. In response, Ginkgo’s legal counsel advised that an additional 22 investors subscribed for shares of Ginkgo without the involvement of either legal counsel or Sterling Grace. In contrast, Sterling Grace’s “administrative” role was described in the same letter as follows:

Sterling’s mandate was initially limited solely to filing a report of trade for the 19 subscriptions which had already closed prior to Sterling’s engagement. Sterling did not and has not solicited investment in the Corporation. Its role was limited to a purely administrative one in filing the report of trade. In relation to that filing, Sterling conducted the following: (i) reviewed the subscription documents for completeness; (ii) verified the identity of the subscribers; and (iii) ensured the completion of KYC forms for its records.

[Emphasis in the original]
20. In the response from Sterling Grace, Casale confirmed in writing on June 19, 2012 that “the information provided with respect to the involvement of [Sterling Grace] [with respect to the 22 investors] is accurate. As provided, Sterling’s involvement was strictly that of an administrative one...”. The confirmation provided covers both contradictory statements outlined in the preceding paragraph. As well, Casale also advised Staff that she had been paid approximately \$10,000 in respect of the 22 trades.
21. However, as part of the Compliance Review, Staff identified that 6 of the 22 investors involved in the second distribution of Ginkgo shares had signed Sterling Grace KYC forms between March 1 and June 19, 2012 (the date of the written confirmation by Casale to Staff referred to in the previous paragraph). As well, the dates on the KYC forms (most of which are signed and dated by Casale) are the same as the dates on the Ginkgo subscription forms for the second distribution.

Trading without registration

Trading in Ontario without registration

22. ML became registered with Sterling Grace in February 2012. Prior to his registration with Sterling Grace, ML was registered with another EMD from August 2011 to December 2011.
23. Staff identified six trades by ML through Sterling Grace prior to ML being registered with Sterling Grace. Each of these trades is recorded on Sterling Grace’s trade blotter.

Trading in British Columbia and Alberta without registration

24. Eleven investors in British Columbia and Alberta purchased securities of Redstone between January 2011 and the date Sterling Grace became registered in those provinces. A Sterling Grace KYC form was completed for each trade and each trade is recorded on Sterling Grace’s trade blotter.

Improper reliance on prospectus exemptions

25. Staff alleges that the Compliance Review identified at least 22 clients of Sterling Grace that either did not qualify as accredited investors, or for whom Sterling Grace had insufficient evidence to support reliance on the accredited investor exemption. Several examples were provided by Staff and some of the clients that were interviewed by Staff provided information that conflicted with their KYC form. Most of the clients invested based on the net financial assets test. Limited information was provided on the KYC form as to the components of net financial assets. As a result, Staff alleges that Sterling Grace had, at best, insufficient evidence to support reliance on the accredited investor exemption.

Failure to discharge the KYP obligation

Redstone

26. Redstone is a Canadian-based company that provides loans to small and medium-sized businesses that would not qualify for conventional financing. Casale advised Staff during the Compliance Review that while some of the loans in the Redstone portfolio had missed payments, none were in default. She further advised that between December 2012 and April 2013, she understood that two loans had defaulted, but that it was her understanding (based on information obtained from periodic meetings with ES) that there would be no losses to the fund.
27. The October 2012 offering memorandum of Redstone clearly indicates that Redstone has loans in the aggregate amount of approximately \$1.3 million that are in default and Redstone's interim financial statements as at May 31, 2012 show impairment losses of approximately \$160,000. As well, a loan portfolio summary dated November 2012 provided to Staff indicates issues with many of the loans in the Redstone portfolio.
28. As a result, Staff alleges that Sterling Grace did not sufficiently know the Redstone product that it was selling to its clients.

Genwealth

29. The Genwealth offering memorandum indicates that Genwealth's portfolio mix will include private and public companies, that it will largely remain a passive investor, and that it may incorporate select short positions.
30. According to Genwealth's website, the fund's portfolio contains three early stage start-up companies. In addition, Genwealth is not a passive investor because ML is playing an active management and consulting role in each of the three investments. Staff's information is that ML's previous work experience is limited to a part time job with his father's construction company and his relatively short dealing representative experience with another EMD and Sterling Grace.
31. Because of the significant differences between the business proposed to be carried out by Genwealth and the actual business carried out by Genwealth, Staff alleges that Sterling Grace did not sufficiently know the Genwealth product that it was selling to its clients.

Failure to discharge the KYC and suitability obligations

32. During the Compliance Review, Staff determined that in the case of 45 clients who invested in securities of Redstone or Ginkgo through Sterling Grace, the investment was either unsuitable or Sterling Grace did not have sufficient records to demonstrate that they were suitable.
33. For example, some investors with a declared risk tolerance of "low" invested in Redstone, a confirmed speculative investment. In addition, other investors with a one to three year liquidity need invested in four year Redstone promissory notes. In some cases, after the Redstone investment was made a revised KYC form was completed by the client which either increased the client's risk tolerance from low to high or changed their liquidity need from 1-3 years to 3-5 years. As a result, Staff alleges that Sterling Grace, at best, had insufficient evidence to discharge the KYC and suitability obligations for the 45 clients.

Reasons for decision

34. For the reasons set out below, my decision is to impose the sanctions requested by Staff as set out in paragraph 1 of this decision. My decision is based on the:
 - a. written and verbal submissions of Mark Skuce (Legal Counsel, Compliance and Registrant Regulation Branch) and Melissa MacKewn (counsel to both the Registrants),
 - b. written submissions of the Registrants,
 - c. affidavits of Karin Hui and Chris Zolis (Accountants, Compliance and Registrant Regulation Branch), and
 - d. testimony of Casale.
35. Section 28 of the Act provides that the registration of a person or company may be suspended if it is determined that the person or company is not suitable for registration (i.e. possesses the requisite integrity, proficiency and solvency), or has failed to comply with Ontario securities law, or that their registration is otherwise objectionable.

36. The meaning of integrity was debated in this OTBH and in *Re Sawh* (2012), 35 OSCB 7431 (Sawh), a recent decision at the Commission level which was later upheld by the Divisional Court in *Sawh v. Ontario Securities Commission*, 2013 ONSC 4018. At paragraph 264 of *Sawh*, the Commission wrote:
- In determining the integrity of the Applicants, however we are guided by the principle that the Commission shall consider in pursuing the purposes of the Act which... is “the maintenance of *high standards of fitness and business conduct to ensure honest and responsible conduct by market participants.*” [Emphasis in the original]
37. Based on the principle reiterated in *Sawh*, integrity encompasses more than dishonesty or fraud, it includes honest and responsible conduct.
38. Staff referred me to a number of precedent decisions including *Re Quartz Capital Group Ltd. et al.* (2012), 35 OSCB. 9457, *Re White Capital Corporation and White* (2013), 36 OSCB 5313 and *PCPF Corporation and Crenian* (2013), 36 OSCB. 9855. In my view, the sanction imposed in this case is appropriate and reasonable compared to these precedents.
39. Registrants’ counsel referred me to an additional precedent decision *Re Kingsmont Investment Management Inc. and Warner* (2013), 26 OSCB 9577 (Kingsmont). Counsel argued that the issues in that case appear to be very similar to the issues in this case. In *Kingsmont*, the Director imposed a six month dealing representative ban on Warner, with no suspension of the firm and no CCO or UDP sanction. In my view, this case is not a relevant precedent because Warner had (as set out in the decision) already agreed to sell his firm and resign as CCO and UDP. As a result, the circumstances of that case are clearly distinguishable from the circumstances of this case. Absent these sanctions, Casale confirmed that she would continue to own and operate Sterling Grace and act as its CCO, UDP, and sole dealing representative.
40. Registrants’ counsel also argued that I should “reframe” the issues in this case to issues of proficiency, rather than integrity. With respect, I disagree. In my view, the issues categorized by Staff as integrity issues are, in fact, integrity issues.
41. Registrants’ counsel also advised that the Registrants were prepared to take any steps necessary to correct the deficiencies identified. For example, the Registrants were prepared to hire a consultant or to hire another individual to be CCO and UDP, provided that Sterling Grace could remain in business with Casale as a dealing representative of the firm (with terms and conditions relating to strict supervision). By definition, the UDP of Sterling Grace cannot be anyone other than Casale and, since Casale is the sole dealing representative, it was unclear to me who would supervise her.

Issues 1-4 relating to integrity of the Registrants

42. In my view, Staff has proven its allegations with respect to issues 1-4 – conflicts of interest, unreported capital deficiency, misrepresentations to Staff and trading without registration. Each of these allegations relate directly to the integrity of both the Registrants and I find that both the Registrants lack the requisite integrity to remain registrants.
43. In my view, it is clear that the Registrants were in a conflict of interest position with both Redstone and Genwealth. I find that the Registrants failed to comply with section 13.4 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103) and section 2.1 of OSC Rule 31-505 *Conditions of Registration*. It was not reasonable for Sterling Grace or Casale to assume that they could obtain personal and operating loans from Redstone (or its principal “ES”), receive significant compensation from selling Redstone securities, and to conclude that there was no conflict of interest created. The perhaps somewhat less significant conflict, although in my view clearly still a conflict, was selling products for which one of Sterling Grace’s two dealing representatives at the time was the president of the general partner.
44. With respect to the unreported capital deficiencies for April and May 2012, I find that the Registrants failed to comply with section 12.1 of NI 31-103, despite Casale being aware of these obligations. Terms and conditions on Sterling Grace relating to a capital deficiency as at December 30, 2010 had just been removed by Staff, and terms and conditions on Sterling Grace’s registration were not again recommended by Staff for the capital deficiency as at December 31, 2011 because of representations made to Staff about Sterling Grace’s positive working capital position as at January, February, March and June 2012.

45. With respect to Staff's allegations about misrepresentations to Staff, in my view it is reasonable for me to draw the conclusion that Sterling Grace was in fact involved in the second distribution of Ginkgo securities, contrary to Casale's written confirmation to Staff in June 2012. As a result, I find that the Registrants misrepresented their involvement in the second distribution of Ginkgo securities. And, since Sterling Grace filed a Form F1 relating to the first distribution of Ginkgo securities (and also received a fee for that distribution), I think it is also reasonable for me to conclude that the Registrants were involved in that distribution as well.
46. I also want to comment on the so called "administrative" function that Sterling Grace performed with respect to the Ginkgo distributions. Casale described this function during the OTBH as not "effecting" the trade, contact with clients after the fact or upon reinvestment or renewal of the securities, maintaining their files (including KYC documentation), performing a suitability review based on KYC information on reinvestment or renewal, receiving a fee, and filing the report of distribution. The administrative function performed by the Registrants is also described in paragraph 19. Casale did not seem to be aware that determining suitability for an investment was different than assessing whether a client could qualify for an exemption. My view is that some, or perhaps all, of the administrative duties performed by the Registrants constituted registerable activity. I do not believe it is appropriate for a registrant to claim that they were only essentially "papering" a transaction after it had occurred and for those activities to be considered as activities outside of their registration.
47. With respect to trading without registration, it is clear from the evidence provided at the OTBH that ML traded securities to Ontario residents on behalf of Sterling Grace prior to his registration with Sterling Grace and that Sterling Grace traded securities to residents of British Columbia and Alberta prior to its registration in those provinces. As a result, I find that ML and Sterling Grace failed to comply with section 25 of the Act.

Issues 5-7 relating to proficiency of the Registrants

48. In my view, Staff has also proven its allegations with respect to issues 5-7 – improper reliance on prospectus exemptions, failure to discharge the KYP obligation, and failure to discharge the KYC and suitability obligations. Each of these allegations relates directly to the proficiency of both the Registrants and I find that both Registrants lack the requisite proficiency to remain registrants. And since each of the proficiency issues relates directly to the proficiency of a dealing representative, these proven allegations support the suspension of Casale's registration as a dealing representative.



"Marianne Bridge", FCPA, FCA
Deputy Director, Compliance and Registrant Regulation Branch
Ontario Securities Commission
Dated: November 18, 2013